THE US-CHINA BUSINESS COUNCIL
美中贸易全国委员会
1818 N Street, NW Suite 200 Washington, DC 20036-2470 USA
Tel: 202-429-0340 Fax: 202-775-2476 www.uschina.org

China's Exchange Rate Policy

Testimony of John Frisbie
President, US-China Business Council
before the
House Committee on Ways and Means
September 15, 2010

The US-China Business Council (USCBC) believes that China's exchange rate should better reflect the market influences from trade flows.

USCBC believes that legislation will be counterproductive to reaching that goal.

Why? First, most trade lawyers believe that addressing the exchange rate with countervailing duties would violate World Trade Organization (WTO) rules. We do not think it is in the United States' interests to pursue measures that flout global trade rules. We would almost certainly find this path used against us by others. And, we do not believe that losing a WTO case would strengthen our hand on this issue.

Second, we oppose legislation that is based on an estimate of the "true" value of the renminbi. Exchange rate estimates are highly subjective and vary greatly depending on who is doing the estimate and the assumptions they use. Ten different economists will give ten different answers; at best, only nine of them will be wrong. Even the IMF's Chief of China Mission said that estimates of the exchange rate "don't do a good job and are not reliable."

USCBC further opposes legislation because it will not achieve the purported goals. USCBC and many respected economists do not believe that the exchange rate has as much impact on the US trade deficit or on US employment as many claim. Much of what the United States imports from China is product that we imported from elsewhere before, not things that were made in the US. The television set is a good example. Today, the label on the back probably says made in China and the TV set is an import. Ten to fifteen years ago, the label probably said "Made in Japan" – but it was still an import. If the exchange rate appreciates to the point that we no longer import something from China, in many if not most cases we will import it from somewhere else, not make it in the US. The recent tariffs on imports of low-end Chinese tires under section 421 of the trade law are a good example – imports from China are down 26%; imports from Japan, South Korea, Taiwan, Indonesia, Thailand, and Mexico have more than filled the void and imports of low-end tires overall are 21% higher than before the tariffs.

We often hear the claim that trade with China has cost 2.4 million American jobs. This claim is based on the faulty premise that everything we import from China would be made in the US otherwise. That's clearly an erroneous assumption and undermines the credibility of the number.

China's exchange rate appreciated nearly 20 percent between 2005 and 2008, but the US trade deficit with China grew during this time. A recent report accounted for this apparent anomaly by suggesting a lag effect between the appreciation and its impact on the US trade deficit, which decreased remarkably in 2009. However, the improvement in the US trade balance in 2009 was far more likely due to the global recession than a lag effect of China's appreciation, as many respected economists have replied in response to that report.

What to do to get to the goal? Continue the coordinated, multilateral approach on this issue, through all available channels. A multilateral approach has shown to be effective on other issues, such as China's indigenous innovation policies. Although not fully resolved, China has paused the program and is re-thinking its policies in the face of unified, multilateral engagement.

I was in China two weeks ago and met with senior officials in a variety of government ministries and the central bank. Economists in China agree that China's exchange rate should better reflect market influences. It is in China's own interests. China imports energy; a stronger currency would ease energy costs. China imports soybeans; a stronger currency would positively impact food prices for China's consumers.

The problem is that this issue has become politicized in China, and the economics are being ignored as a result. USCBC's Beijing-based vice president was invited to participate in a discussion just yesterday at China's central bank. He was the only American in a roomful of China's best US policy thinkers. He made strong arguments why China's exchange rate should appreciate; some agreed. However, he reported that the near-unanimous view of these US policy experts was that if the US Congress pursues China currency legislation, China should not move its exchange rate.

The past is useful guide. A few years ago, when Senator Schumer's legislation was under consideration, China's exchange rate appreciated about 4.6 percent over 17 months. When Senator Schumer withdrew his legislation and Treasury Secretary Paulson stepped in to engage China on the issue, China's currency appreciated 13.4 percent over the next 22 months – or twice as fast, on a monthly basis.

Let me be clear: The US-China Business Council believes China's exchange rate should better reflect market influences. China's currency is probably undervalued by some amount, given that it is running global current account and trade surpluses. How much is China's currency undervalued? I don't know, and no one knows for sure – a lot of factors impact exchange rates. It is probably not as undervalued as many here claim. And it impacts the US trade deficit and employment less than many here claim.

But, the goal has to be for China's exchange rate to show more movement. Frustrations are high, but legislation will not help us get to the goal, for the reasons explained above. As of yesterday, China's currency has strengthened 1.3 percent since June's announcement of resumed rate flexibility, or 5.2 percent annualized. We need to continue to support the Obama administration's bilateral and multilateral engagement with China on this issue, and this committee should firmly direct Treasury Secretary Geithner to do so when he testifies tomorrow.

Thank you.